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General Business Conditions

THE year just ended has been by any measure the busiest in the country's peacetime history. More people have been at work, the industries have turned out more goods, and the farms have produced larger crops than ever before. The Federal Reserve Board's index of industrial production has averaged about 192 (1935-39 = 100), an increase of 3 per cent over 1947, the previous peacetime record year. Crop production, according to the Department of Agriculture, has been 9 per cent above the previous peak in 1946. The output of animal products has been a little lower, reflecting the short feed crops of 1947, but the abundant feed supplies now on hand are already increasing poultry, dairy and meat production again.

It follows from these facts that the general standard of living is also the highest in our history. Many people, finding retail prices and the cost of living oppressively high, may question that conclusion. But the measure of economic welfare is the physical volume of goods produced and consumed, and by that test the country has never had so much to enjoy. The other side of high prices is high money incomes. Personal incomes in 1948 have totaled some $212 billion, 8½ per cent above the 1947 record. Consumers' expenditures have exceeded 1947 by 7 per cent.

The dollar totals of investment in plant and equipment by the industries, and of expenditures on housing and other private and public construction, have been the largest ever reached. In some cases the physical output represented by the dollars has been less than in one or two earlier years. But in many other cases physical records also have been set. Thus people have not only been living well, but the real wealth stored up through additions and improvements to productive facilities and in stocks of durable goods has been increased probably more than in any previous year. Expanded and improved productive facilities lay the foundation for future gains in living standards, provided the work and cooperation needed to make the most of them are forthcoming.

Looking Backward at 1948

Many people doubted, at the beginning of 1948, that the year would turn out as well as it has. Some had looked for a slackening even in 1947, and when 1947 closed at record levels they felt that the boom could not possibly last far into 1948. Others were impressed by declining bond prices and evidence of tightening credit at the end of 1947. They felt that the money was running out and that the boom would end for lack of lending to finance it.

In fact, the boom has run out in specific lines. Cotton goods, shoe and clothing people have had problems of weakening demand almost throughout the year. Producers of a good many things, including luxury goods and services, have seen buying shift away from them toward other outlets. Buyers' markets and the competition that goes with them have returned.

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In the overall situation, however, it is seen in retrospect that the anxieties felt twelve months ago were at least premature and in some respects unfounded. The weaknesses which aroused apprehension have had less influence on the year's business than the strong points and the supporting factors. Demands on the industries have been not only large enough to keep industrial labor and materials fully employed, in the aggregate; they have been so strong as to keep up inflationary pressures during most of the year. The money has not run out. On the contrary, money has continued available to good borrowers at rates and terms historically low, and expenditures have been financed readily. Security issues to raise new money totaled over $8 billion in the first 11 months of 1948 compared with $6½ billion a year ago. New savings available for investment during the year have been supplemented by the proceeds of sales of government securities to the Federal Reserve Banks. The influence of the Federal Reserve pegs on governments in keeping the inflation going was one of the factors in the 1948 outlook whose importance was not sufficiently recognized at the beginning of the year.

Opinions on the 1949 Outlook

The foregoing is retrospective. Turning to 1949, any poll of opinions on the outlook would probably show that doubts are more widespread now than they were a year ago. For this there are two main reasons. In part, the uncertainty repeats the feeling of last year, now stronger because more time has passed, that "catching up", plus maladjustments and weaknesses, must end the boom. The second main reason is the prevalent fear that government policies in the coming year will weaken the will and ability of business to make capital expenditures.

In fact the business situation is a complex mixture of deflationary and inflationary influences. Most current evidence, including the price trend, indicates that the inflationary forces have weakened. As 1948 has moved to its close the soft spots have increased in number. Many industries tell of a fall in sales. More reports of curtailment are noted, and the unemployment compensation figures have risen a little more than is seasonally expected. Christmas trade in the aggregate, while good, did not come up to earlier hopes and greater promotion effort was needed to make it as good as it was.

Underlying the change in current reports are both sentimental and tangible factors. The psychological element shows itself in efforts, both in industry and trade, to reduce inventories and shorten commitments. Consumers seem more ready and able to wait for lower prices. The tangible factors include the filling up of pipelines and catching up with deferred wants. They include the effects of inflation in reducing the buying power of people with fixed or lagging incomes.

In the broad sense it appears that the primary inflationary force, which was the wartime expansion in the money supply, has finally been absorbed by the combination of increased production and higher prices. Prewar relationships between the money supply and the value of the country's production are now approximately reestablished. The inflationary pressure, insofar as it results from a superabundance of money, therefore appears to be wearing itself out.

The Elements of Strength

On the other hand, it would be hard to find evidence that an active deflation or liquidation is setting in. In many and very important lines backlogs of orders are still heavy. Buyers are still crying for more steel and more of the non-ferrous metals. If demand for the latter should ease, the Government would fill the void by purchases for its stockpile. By all signs the producers of at least the lower-priced automobiles will be able to sell in 1949 all the cars they can make; and they plan to make more than they did in 1948, which signifies that they will want more materials and take up slack which may develop from other buyers.

Uncertainty is expressed about the outlook for business expenditures on plant and equipment. But a survey made by the Department of Commerce and the Securities and Exchange Commission, which in the past has proved a reliable indicator, places the total for the first quarter of 1949 at $4,390 million. This is a drop from the $5,010 million in the fourth quarter of 1948, as would be expected because of the influence of the winter on construction. But it is an increase of $220 million or 5 per cent over the first quarter of 1948, and gets the year off to a good start. State and local governments are virtually certain to do more building than last year.

The export outlook is for a continuation of shipments around the current level of about a billion dollars a month, or very little below it, because of the stabilizing influence of the Marshall plan shipments. Only about 40 per cent of the $2.2 billion of American goods authorized for purchase under E.C.A. through November had then been shipped. The percentage of industrial goods, compared to agricultural products, in the authorizations continues to rise.

Underneath the business structure is the supporting influence of a strong financial situation.

Corporate and personal debts rose further during the year, but it seems correct to say, as was the case a year ago, that ratios of debt to net worth are not in general a cause of concern. There is no money stringency, such as has heralded previous periods of liquidation and depression. On the contrary, the unprecedented liquid assets in the form of cash, short-term government securities and redeemable savings bonds are a source of strength. The rate of saving has risen.

In 1949 the Government will be pouring out more money into the hands of people, and taking less away from them. In the first half of 1948 the Federal Treasury took in $7.6 billion more than it paid out, and used the money principally to pay off government debt held in the banking system. This was deflationary, although it caused no business setback. In the first half of 1949 it is doubtful that the cash surplus will be as much as one-third of the 1948 figure. The difference in part is lower taxes, in part larger Treasury expenditures, of which the armament orders reaching various industries are visible evidence.

To many it will seem that the net of the possible minus change from 1948 in business expenditures, construction and the export surplus, and the plus change in government transactions, will show no considerable balance on either side. This leaves open the question of inventory changes and consumer expenditures, in which psychology, or the will to spend, enters largely. The influential factor is what people think of the future, and government policies and unpredictable events will affect their feelings.

On one aspect of the outlook general agreement may be reached. It is that buyers' markets and competitive conditions will prevail in 1949 over a greater part of the economy than in any year since the war began. Such a change, although it implies a test of weaker enterprises, is inevitable and salutary. It will promote efficiency in the economic organization and give some relief to the people hard pressed by inflation. It is altogether desirable that some of the fever which has characterized business at times during 1948 should pass out of the situation, and that adjustments should take place while the supporting factors are so strong.

The Coming Presidential Messages

The messages which the President will deliver to Congress in January on the state of the Union, the budget, and the economic situation are certain to have a pronounced effect upon business sentiment. Questions to which people are seeking answers are innumerable. What defense expenditures will be proposed? What new welfare measures will be urged, and at what cost? What foreign aid? What will the total budget for fiscal 1950 amount to? Will higher receipts be needed to balance the budget, and if so what kind of taxes will be asked?

A basic question is whether the President will make his recommendations on an assumption that a resurgence of inflation threatens, as he may if proposed expenditures show a huge increase. The official view will not only color the recommendations on taxation, but will determine whether price and other direct controls will be strongly urged.

Apart from fiscal matters, other questions are pressing. What new labor legislation will be asked for? What changes in the present provisions for support of farm prices will be favored? Should business expect new regulatory measures?

Fiscal Principles

We shall not attempt to anticipate the President's answers to these questions. Whatever he proposes will be long debated both in and outside Congress. But certain principles should be clarified at the beginning of the debate, and particularly those which relate to fiscal policy. One is that the security of the country is paramount, that it is worth what it costs, and that the burden must be borne. A second is that the defense program should be planned carefully and executed economically. Because the term "defense" is attached to the expenditures is no reason to condone waste or extravagance. The way to avoid them is to enforce singleness of policy and coordination of effort, with no room for inter-service rivalries, with adequate control at the top, and efficiency at all levels.

Combining these two principles, people may properly question the costs of defense, but cannot properly argue that, because sacrifice and self denial may be required, the country cannot afford them. It would have been just as proper to contend that the country could not afford to fight Germany and Japan because it could not bear the cost.

A third principle is that the present is no time to increase expenditures for any other purpose, including expanded public works, aids to education, or similar new proposals for the public welfare. When a budget deficit threatens because an emergency exists and urgent security expenditures are straining our resources, the way to lighten the burden is to economize everywhere else. Moreover, expenditures intended to

promote welfare will fail in their purpose if they keep inflation going or if, alternatively, they are financed by such heavy taxes as to stifle business activity and growth. The people whom welfare expenditures are intended to benefit also have an interest, and fundamentally a greater one, in economic stability and in the jobs which only a flourishing economy can provide.

Tax Proposals

A fourth principle is that while all taxes are burdensome, the greatest long-run harm is done by taxes which weaken business incentive and repress industrial growth. The tax most feared by business at this time, and rightly so, is an excess profits tax. This tax is inequitable because it must be levied on some historical base, which perpetuates every inequality existing in the base period and cannot take account of changes since the base period. Even more serious is the fact that the tax strikes directly at incentive, weakens the inducement to expand production, and thereby destroys one of the strongest forces for growth and progress. It is no exaggeration to say that a peacetime economy which had to operate under a heavy excess profits tax over any considerable period of time would soon stagnate. The arguments for such a tax in time of war, when half of industry is working on government contracts and everyone has wartime motives to keep going, have no reality in peace.

An increase in the normal corporate tax rate has something of the same effect as an excess profits tax, and may take as many dollars away from the profits upon which business depends for its growth. However, it does not involve a higher tax rate on increments of income, and hence does not hit at incentive and progress in such direct and aggravated form.

Proposals that the corporate tax rate be steeply graduated, rising to high figures on large corporations having large dollar incomes, are thoroughly unsound and harmful. Their inequity should be obvious, since there is no natural or necessary relation between the dollar total of profits and their "fairness". A low total of dollar profits reported by a small company may, and frequently does, represent a larger return on net worth or on sales than the large dollar profits reported by the country's industrial giants. Moreover, the ownership of these giants is spread among millions of individual investors, including an immense number of "small" people who would incur the penalty.

These proposals of course are designed to penalize bigness, without regard to its efficiency or any other consideration. In levying discriminatory taxes on bigness as such, the efficient units frequently would be penalized, the inefficient would have a competitive advantage. No one who is interested in advancing the social welfare can really desire this, however advisable it is to encourage small business in all sound ways.

The Choice

The choice that must now be made is whether the enlarged defense expenditures are to be met and the budget balanced by economizing in other directions, or by an increase in taxes that will further burden and discourage the productive part of the economy at a time when it is already fearful of the outlook. The idea that most expenditures are untouchable and that budget balance must be sought always by increasing taxation seems to gain astonishingly as time passes. During the past month the Council of Economic Advisors has presented to the President its third annual report from which we take the following extract:

> Almost half the budget is related to national defense, foreign aid, and public works. In theory, there is a very wide area of discretion in fixing expenditures for these purposes. Actually, there is no basis for any plan which assumes that there will be any substantial reduction. Public sentiment firmly supports the foreign aid policy; it demands a national defense program sufficient to protect national security; it refuses wholly to defer during the period of our greatest national prosperity the public works which had to be set aside during the war years and which are now needed more badly than ever.

The Council approves the general policy of supporting farm prices but says that, even if it did not approve, "we would not be realistic if our recommendations were based on the assumption that it would be abandoned. A long legislative history has attested the strength of the popular affirmation of the farm price policy." The Council also says that the Government's housing program "with its deliberate promotion of easy credit" must be accepted because of the seriousness of the housing shortage, and "anti-inflationary policies must be devised to curb inflation even while the expansion of housing is being encouraged."

Without debating the desirability of welfare expenditures in such form and at such a rate as the country can afford, the statement by the Council leaves the impression that the question of what can be afforded comes in for little consideration. The implication is that what matters to the Council is not whether people are wise, but what they want.

The issue here is not merely that of taking away from one segment of the population to give to another. The more important question is what the resulting taxation and other repressive poli-

cies do to destroy incentive, to restrict economic growth, and to check long-run progress in raising living standards.

Congress Hearings on Profits

The hearings last month before the Senate-House joint committee investigating business profits brought out much useful information on a subject concerning which there has been great confusion and controversy, yet which in the present situation urgently calls for understanding and sound judgment.

During the next few months Congress will be faced with important problems of public policy with respect to prices, wages, and taxes. In the discussions of these matters much has been heard about business profits. To what extent have "exorbitant" profits been responsible for high prices? If profits are "too high", what ought to be done about them? Should wages be increased, prices reduced, or should the Government step in and take away the "excess" earning with higher taxes?

Manifestly, such questions are packed with dynamite. Recognizing the importance of avoiding hasty, ill-advised action, and of getting as near as possible to the facts, the committee subgroup sought the views of economists, accountants, and representatives of industry and labor. Senator Flanders, the chairman, said that the committee wanted to look into the profits situation before Congress acts on legislation relating to taxes, price controls, money controls, and rationing. The subject bears also on the issue of a fourth round of wage increases.

What the conclusions of the committee will be, and how Congress will act, remain to be seen. Senator O'Mahoney, a member of the committee, stated even before the hearings began that business was reaping its greatest profits in history and "must either pay a larger share from profits to the Government or help by cutting its prices."

The great difficulty is that these are political as well as economic problems. But there can be no question as to the wisdom of the committee's approach in giving all parties a hearing and getting the facts on the record where the good sense of the American people can evaluate them.

The Position of Industrialists

In the testimony before the committee, labor economists argued that profits were too high, while industrialists took the position that they were not. Others, including university professors as well as business economists and accountants, stressed the need for high earnings in view of the rise in the general price level that has occurred and the unusual requirements of business for capital.

Four principal points were made by the industrialists. First, that profits as currently reported included a substantial element of inventory gains, which are illusory and non-recurrent. Some profits of this sort are created automatically in a period of rising prices, but such gains are immediately absorbed in higher-priced inventories and larger accounts receivable if the company is to continue in business.

Second, it was emphasized that profits as computed under the usual accounting procedure were overstated, because reserves charged for depreciation of fixed assets were inadequate to replace such facilities at present costs of construction and equipment, up to double or more the prewar level.

Third, the industry spokesmen quoted figures to show that the increase since prewar in dollar profits was not in most cases the result of wider profit margins, but of the tremendous expansion in volume of sales. This dependence upon high-volume operations at margins generally no wider than prewar, and in many important cases narrower, makes business vulnerable to even a moderate downturn in revenues or rise in expenses.

Fourth, it was repeatedly stressed that corporate profits expressed in current dollars have much less purchasing power than if in prewar dollars. The 1948 dollars do not go nearly so far in the purchase of raw materials, labor, and new machinery. As Eugene Holman, president of the Standard Oil Company (New Jersey) put it, "merely to say that our profit is three times that of 1940 has no more meaning than saying to a fisherman: 'You caught 100 fish in 1940 and 300 fish this year, so you are three times better off.' One question to be asked is: 'What size fish were they?' Inflation has changed our fish – the dollar."

Views of Economists and Accountants

An estimate of $16.4 billion as the extent to which the earnings of American corporations have been overstated during the past three years was given by Sumner H. Slichter, professor of economics at Harvard University. This, he said, is the amount by which the reported statements of profits exaggerate the amount of income available to pay dividends, to expand plant, to increase wages, or to reduce prices. Professor Slichter explained that the overstatement resulted from the fact that most corporations still insist on counting as profits the rise in the cost of re-

placing inventories, plant, and equipment. He added that, "it is obviously ridiculous to count a rise in costs as profits and yet most corporations do it, and pay stiff taxes on the amounts so reported."

William A. Paton, professor of accounting at the University of Michigan, agreed that an important aspect of the present situation is that corporate net earnings as currently reported are generally overstated to a significant degree, particularly from the standpoint of using such figures to measure the relative economic positions of those furnishing funds and those furnishing personal services.

George D. Bailey, certified public accountant and past president of the American Institute of Accountants, also emphasized the fact that corporate profits, or earnings, or income, are not the same as distributable profits. He added that, "In my experience as an accountant I have seen the cash reserves of many companies eliminated and borrowings required because the necessary replacements of plant had to be made at current high prices."

On the other hand, Seymour E. Harris, professor of economics at Harvard University, stated that while it was not easy to give a precise answer to the question as to whether profits were or were not too high, his considered judgment was that they were. He based this, however, less upon ethical considerations than upon the effect of excessive profits in promoting an unprecedented level of investment, "one of the greatest inflationary factors", in increasing the pressure on trade unions to ask for higher wages, and in stimulating uneconomic expenditures which will be costly once the inflation ends. He pointed out that rising prices are not the result primarily of high profits, but of a $400 billion war, with its expansion of money and incomes beyond the supply of goods available for purchase with the excess liquid resources.

Arguments by Labor Economists

Representatives of two large unions and of the A. F. of L. and C.I.O. central labor organizations took sharp issue with points made by the industrialists and others.

First, rejecting the margin of profit on sales as a fair criterion for the measurement of earnings, the labor economists stressed the large gains over prewar levels both in dollar profits and in rate of return on book net worth.

Second, they denied that profits generally were overstated, contending that inventory profits were "real", even though immediately tied up in inventory replacements at high prices, and that depreciation charges should continue to be based upon the recovery of original costs, rather than upon the future requirements for plant replacements. They charged that, actually, profits were understated, through the use of various accounting devices such as the LIFO method of inventory valuation, and special charges and reserves against inventories, plant replacements, contingencies, etc.

Third, it was argued that by charging excessively high prices, companies increased their earnings greatly, and were able since the war to finance from retained earnings some 70 per cent of their requirements for plant expansion and working capital. This, it was asserted, represented in effect a tax on consumers to finance industrial expansion, instead of obtaining additional capital from investors through the sale of new securities.

Fourth, it was said that the high proportion of earnings retained was used not only for plant expenditures, but also for buying up other companies and thus fostering monopoly. Moreover, that expansion from retained earnings tends to build up giant corporations without their having to submit their new security offerings and their expansion programs to the test of the market.

Fifth, great stress was laid on the decline since VJ-day in the "real" income of labor, due to the fact that prices have increased more than money wages. It was asserted that today's high prices and high profits are bringing about a reduction of buying power which threatens the maintenance of prosperity and full employment.

The Real Issues

The foregoing necessarily represents only a very condensed summary of the many points brought out in the hearings. Unquestionably these claims and counterclaims are confusing, and there is danger of "not seeing the forest because of the trees."

It would be easy to get sidetracked by accounting technicalities about which experts themselves disagree. There will be found among the 420,000 American corporations an almost endless variation both in accounting methods and earnings trends.

Likewise, there is futility in arguing about the relative income or well-being of different groups on the basis of percentage changes from some particular period in the past. Almost anything can be shown, depending upon the dates selected. Labor, for example, is prone to emphasize the change in purchasing power of wages since the end of the war, when "real wages" stood at their all-time peak, whereas a different

picture will be shown if the measurement is from prewar.

It is necessary to stand off and take a look at some of the broader considerations.

All businesses, regardless of size or accounting methods, have been affected by the rise in the general price level and the consequent decline in the purchasing power of the dollar. While labor and the public at large have been acutely conscious of this deterioration in the value of the incomes which they receive, there has been a tendency to overlook the fact that the value of business income has shrunk similarly. In other words, business too has its high cost of living problem.

Another point is, who gets these profits? Certainly they have not represented a levy on the public for the enrichment of a small privileged group of capitalist stockholders. American business has an estimated fifteen million shareholders. While dividends in the aggregate have increased, their proportionate share of the total corporate net income, estimated at 38 per cent in 1947 and 1948, was the lowest, except for 1916, in the forty-year period for which comprehensive dividend records are available. When further allowance is made for the decline in purchasing power of the dividend dollar, coupled with the steeply-progressive personal income taxes, the shareholders, along with the bondholders, whose income is fixed, seem to be the "forgotten men."

This leads to the third, and by far the most important point, namely, that the great bulk of these profits has been used for increasing production and thus supplying the accumulated wants of the American people. Not only have good profits created the incentive for new investment, but they have provided a large share of the money needed. By making possible the great outpouring of finished goods, they have already solved the problem of shortages in many lines.

Alternative Sources of Capital

As for the criticism that the capital for expansion should have come from sources other than retained earnings, the fact is that substantial sums in addition were raised from short and long term bank loans, long term insurance loans, and from the sale of bonds, debentures, preferred stock and common stock.

But the raising of money by the sale of new equity securities has proved difficult and costly, despite high earnings. The reasons have been various, including the depressed market for outstanding shares, the high individual income taxes which have cut the savings of large investors, and the high margin requirements which have limited the purchase of securities in anticipation of future income, as well as the cost, delay, and uncertainty incident to registration of new offerings of securities.

Although it is argued that higher dividend rates would have improved the equity market, the extent of such improvement is questionable in view of the many adverse factors affecting the corporate shareholders. It will be noted that stocks are selling at abnormally low prices not only in relation to earnings and book values, but also in relation to current dividends. Moreover, the higher dividend payments would to a large extent be siphoned off in taxes and thereby go to the Treasury, rather than being available for reinvestment in new corporate issues.

For industry to have borrowed more would have meant increasing the total of corporate debt, which businessmen, remembering the lessons of the past, have been reluctant to do in a period of boom. It would have involved also more credit expansion, which the monetary authorities have frowned upon as adding to the inflationary pressures on prices.

Effects of Higher Taxes

On these points as to the heavier requirements for, and sources of, new capital, the testimony by Walter Hoving, president of the Commerce and Industry Association of New York bears repeating. Warning of the danger of saddling industry with higher taxes, he said:

> The public should be made familiar with the fact that the average investment for plant and equipment necessary to put a man or woman to work in an American manufacturing plant is \$8,389.00. The range is from \$3,759.00 per wage earner in textiles to \$21,205.00 in the telephone system, and \$27,375.00 in chemicals. In addition, it costs several thousand dollars more in capital funds for inventory and working capital to keep them at work.
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> Some of these funds always have come from profits that have been plowed back into the business. More and more of them must come from that source in the future because of the difficulties in obtaining equity capital at the present time. An increase in corporate taxes, either by way of excess profit or straight income taxes would further dry up the equity markets because such action would be a serious threat to the continuity of dividends.

Under a 38 per cent corporate income tax, Mr. Hoving pointed out, a corporation must earn \$3.24 before it can invest one dollar in its plant and pay one dollar in dividends. Under a 50 per cent tax, corporations would have to earn \$4.00 in order to reinvest one and pay out one in dividends. These dividend dollars, he emphasized, not only are taxed as part of the income of the person who receives them, but they buy only about half as much as the 1928 dollar.

The Proof of the Pudding

In short, what the issue boils down to is that high earnings were essential to supplying the great expansion of industrial capacity, employment, and production which the American people wanted, and which they got. It is true that there was an effort to crowd too much of this expansion into too brief a period, with consequent intensification of the demands for manpower and materials. All this, however, was part of the price for getting the job done, and already the increased production and growth of competition are putting a natural brake upon inflationary tendencies.

Among the many fields of business in which these forces have operated, the petroleum industry is outstanding. Testifying before the committee, Joseph E. Pogue, petroleum economist and vice president of the Chase National Bank of New York, explained how the petroleum industry had averted the threatened rationing of gasoline last summer and fuel oil this winter. Referring to the huge cash outlays for the expansion of oil production, refining, and distribution facilities which, despite high profit totals, left the industry "strapped" for cash, he went on to say:

> A year ago we faced the prospect of a tight, if not short, oil supply. Today our tanks of oil are full and supply is beginning to run ahead of demand. If this trend continues, the need for capital formation will become less insistent and the mechanism of the market will reduce profit margins and bring about a lower level of "profits." In this cycle, we have an almost perfect example of the function of "profits" in converting an economy of oil scarcity into one approaching abundance.

Here, in a few words, is a story that could be paralleled again and again from what is taking place throughout industry. It is in the light of such accomplishments that the present levels of business profits must be judged. The terms "retained earnings" and "undistributed profits" tend to give the idea of cash piled up in corporate treasuries and withheld from use. Actually these "retained" and "undistributed" earnings were being paid out—"invested" in improving and enlarging the machinery of production. Everyone benefits from this process, the workers and shareholders, as well as the public at large.

Innovations in Coal Mining

The new "coal mole" or "colmol," demonstrated at New Lexington, Ohio last October, and the "continuous miner," shown publicly at Finleyville, Pennsylvania in December, give promise of further achievements by the coal industry in getting more coal out of the ground with fewer men. They illustrate the formula whereby, under our system of competitive enterprise, work can be made easier and the products of industry more plentiful and cheaper.

These new machines, designed for underground mining of bituminous coal, cut and load in a continuous operation and eliminate the need for successive drillings and blastings. Fewer men are required in the mines; and both the hazards, and the number of men exposed to hazard, are reduced. Either machine requires four men and can produce two tons or more of coal per minute. On the basis of six and a half working hours per day, and with allowance for ancillary work of mine and machine maintenance, the inventors figure that production of coal, under favorable conditions, can be raised to as high as eighty to one hundred tons per man-shift. In terms of the old pick and shovel, such figures border on the fantastic; and they would represent very substantial gains over even the most advanced previously available techniques.

Behind these new machines are years of patient research, financed by someone who was willing to risk money on an idea that *might* work. The "colmol" has been in development for several years. A model of the "continuous miner," which was originally conceived by a Denver engineer, has been in experimental use in a Colorado lignite field since 1947. Other experimental models have been in trial use, for shorter periods, in the Pennsylvania and Illinois fields. Like any new device, these machines doubtless still have some "bugs" for experience to comb out. Time will show how they can be improved. Other people, experimenting along similar lines, may come out with something better. But it is significant that such machines have now reached a stage where plans are being made to produce them on a commercial scale and where inquiries are being received from mining companies that want to use them.

The introduction of machines for continuous mining, and a widening use as they become available and perfected, can keep the curve of labor productivity in the coal industry on a rising trend. Official government estimates indicate that output per man per day in bituminous coal mining in the United States is already the highest on record, here or elsewhere. Back in 1890, the first year for which the U. S. Bureau of Mines has an estimate, the figure was two-and-a-half tons per man-day. In 1946 it was above six tons. The regular working day in coal mining, meanwhile, has been reduced from ten hours in 1890 to eight hours at present. Moreover, the former figure is exclusive, the latter inclusive, of time spent by the men in getting from the mine "portal" to the

coal face and back again. If "non-productive" paid time is taken out, the actual working time now is more like 6½ hours a day.

Factors in Labor Productivity

How has it come about that a man today, working shorter hours and under safer conditions, can bring two or three times as much coal out of the ground as his grandfather did sixty years ago? One factor in labor productivity is always the effort and intelligence a man puts into the performance of his job. This is never to be underrated. A maximum effort requires a high morale and comes out of good working conditions, fair pay, and a free choice how to spend it.

Yet for progressive increases in output per man-hour or man-day, over the decades and over the generations, we have to look to other sources. When a man is already putting in a good day's work for a good day's pay it is manifestly unfair to expect more out of him. And it would be difficult to prove to the satisfaction of our elders that we work a great deal harder than they did. The general trend has been all the other way around, toward making life progressively easier and letting the machine carry the load.

Thus we must consider the efforts that "the boss" puts in — in order to strengthen his competitive position and to survive in business — to get more production from a given labor force. His means for doing so are to improve the organization of production and, by saving and attracting new capital, to make it possible to put better tools in the hands of the workman.

In the particular case of bituminous coal mining, data of the United States Bureau of Mines on mechanization show how the rise in labor productivity over the past sixty years has been achieved. Starting around the turn of the century, the Bureau's figures show, machine cutting of coal came into more and more general use as the years passed. Mechanical loading machines, introduced in the nineteen twenties, have become standard equipment in an up-to-date underground mine. The development of "strip-mining" with power shovels, applicable where coal is close to the surface of the ground, dates back twenty or thirty years.

Labor-saving machinery, applied not only in coal but in industry generally, is the essential basis for the rise we have seen over the years in the general standard of living, the shortening of working hours, and, often, reductions in industrial hazards. To keep the tools and machinery in repair, to replace them as they wear out, to discard those that are inefficient, to obtain improvements, we rely on the system of profit and loss. It takes money to make major capital outlays and it takes the prospect of profits to encourage savers who put up the money and to reward the successful inventor.

Tax away the profits of enterprise and essential tools of production will wear out without replacement. Shut off the streams of new savings and credit inflation becomes the only route for financing the development and purchase of better machines. Interfere with the incentive to the individual to search out easier and cheaper ways of getting work done and economic progress drags to a halt.

The Interferences

One kind of interference with the processes of technical improvement comes from interests that want to protect the *status quo*, oppose the introduction of faster machines, limit production in order to spread the work, or insist on the hiring of unnecessary help to conform to outworn "operating rules."

Such rules, notorious among some of the railway unions and construction trades, have no place in the policy of the United Mine Workers. In an interview published in the *U. S. News & World Report* of November 19, John L. Lewis, president of the Mine Workers, referred with satisfaction to the American productivity figure of 6.11 tons of coal per man-day which he compared with 1.11 in Great Britain and 0.83 in Germany and France. This, he said, reflects:

> The skill of the miner . . . good management, efficient engineering, sound business policies and all such factors . . . The United Mine Workers recognized three or four decades ago that the only way to increase the standard of living in the mining industry was to create new values by greater productivity — more tons per man per day . . . In World War II, for instance, with 300,000 less men than were employed in the industry in World War I, we had a production of some 60-odd million tons per annum greater.

People often decry the machine civilization, sometimes without appreciating that it is a machine civilization that has given them leisure to ponder the virtues of a simpler life or without attempting to calculate whether, without the machine, there would even be enough bread to eat. The easing of the burden of gaining a livelihood, the revolution in the conditions of life over the span of only the last five or six generations, have depended on a rising productivity of men's efforts. Since James Watt showed how wood and coal could be converted into power, in substitution for the limited physical capacities of men, their horses and oxen, the machine has shown the way to the easier and more abundant life we know today.

Problems of German Currency Reform

The recent upturn in prices and note circulation in the western zones of Germany ("Trizonia"), following the initial success of last summer's currency reform, has awakened fresh doubts and anxieties over further progress of German recovery and reconstruction. The rebuilding of the currency is only one part, of course, of the overall problem of German economic, political, and moral reconstruction. Nevertheless, it is an essential part. Without a currency that people can trust, there is no solid basis for normal trade operations, for tax collections, and for the achievement of economic security and freedom on the part of the individual.

The currency reform in the Western zones was put through from the sheer hopelessness of the situation without it, and despite the fact that the German economy was still far from self-supporting. The old reichsmark, given a nominal value of ten cents by the occupation authorities, had so far deteriorated in public esteem that cigarettes along with barter were the preferred means of trade. "Official" prices, in reichsmarks, were maintained for various classes of rationed goods but the goods received as rations were immediately resaleable at much higher prices for those who could afford to part with them or – more to the point – who had any use for reichsmarks. A better job was one that entitled the possessor to better rations, rather than better pay, and there was, instead of an incentive to earn money, an incentive to get rid of it. Efforts were diverted from production to searching out advantageous trades in the so-called black markets. The farmer withheld produce, needed in the cities, because it gave him a safer store of value than the money he could get in exchange for it. In a word, the money economy was broken down.

Thus three years after the war, industrial production in Western Germany was still only about one-half of the 1936 level. Food had to be shipped in, mainly from the United States, in large quantities. American production also was called upon to meet needs for manufactured goods and coal in Italy, the Netherlands, Denmark, and Norway, needs which normally would have been fulfilled by German industry.

The Currency Reform

The chief object of the currency reform was to revive legitimate production and trade and strengthen incentives to work. Other measures were taken at the same time. The tax structure was reformed and the list of rationed and price-controlled commodities was reduced. Income taxes were cut by one-third and the corporate tax set at a uniform 50 per cent, replacing a sliding scale of 35 to 65 per cent.

The currency reform itself involved in principle the exchange of one new deutsche mark for ten old reichsmarks. The same one-to-ten ratio was generally applied to bank deposits except that half of the new deutsche marks ("D-marks" or "DM") received in exchange were temporarily placed in blocked accounts. Salaries, wages, social insurance benefits and rents were continued in the new D-marks at the old rates in reichsmarks but mortgages, bonds, annuities, and other forms of indebtedness were written down to one-tenth. Holdings of old government debt obligations were declared worthless. New D-mark balances were allotted to the banks to maintain their solvency and to the public authorities to maintain the business of government. The plan was in essence that proposed in 1946 by a commission of financial experts headed by Joseph M. Dodge, president of the Detroit Bank.

The currency reform resulted in the conversion or cancellation of 163 billion old reichsmark currency and bank deposits and the substitution of 15.6 billion new deutsche mark deposits and notes. Of this DM 15.6 billion, one-third were blocked balances, and another DM 3 billion represented cash balances of banks and public authorities. The effective money supply in the hands of individuals and business firms was cut to DM 2.6 billion currency plus 5 billion free deposit balances, a total of 7.6 billion.

Almost immediately the reform was followed by unprecedented bustle and activity. By September, industrial production had risen by nearly 50 per cent, to 70 per cent of the 1936 level. In a number of lines the output came up to or even exceeded prewar. The black market collapsed and huge quantities of goods poured from hoards. With plenty of goods displayed in city shops, farmers became eager to sell to get money to buy them. Hundreds of small businesses sprang up almost overnight. With bricks and glass available thousands of homes were again made habitable. There was a sharp decline in factory absenteeism, and the productivity of labor was reported to have risen 35 per cent. Decontrolled prices generally found levels somewhat above the former nominal ceilings but considerably below previous black market quotations.

Fresh Difficulties

These results, surpassing even the most optimistic hopes, may have led to a feeling that the battle

was over. But abnormal additions to the supplies of goods, from dishoarding, were soon sold out. Meanwhile, the effective money supply was enlarged by freeing a part of the blocked deposit balances; by private borrowings from the banks, most notably for repairing homes and for business purposes; and by deficit-spending by individual States and government-owned enterprises.

This last element, it would appear, has been quantitatively the most significant. In commenting recently on the threats to the German currency, Mr. Edward A. Morrow, the New York Times correspondent in Berlin, cited the bizonal railway system as an example of the inflationary pressure arising through the capital programs of nationalized industry:

> It is spending 125 million marks a month for the laying of new tracks, rebuilding of stations, and other rehabilitation activities, and as a result the state railroads are expected to have a deficit of more than 400 million marks by next March.

As to the State governments, Mr. Morrow reports that during the first four months of currency reform they spent more than one billion new marks in deficit financing. A part of this deficit was incurred for occupation expenses, which in the French Zone were reported to have accounted for one-half of the total. The question of occupation expenses is highly controversial, but it is significant that more than 650,000 Germans are now employed by occupation authorities with salaries and wages paid out of State budgets. However, it is the American, rather than the German taxpayer who has the chief ground for complaint. According to General Lucius D. Clay, for each 20 deutsche marks that Germans pay for occupation, Americans pay 80 marks to feed the Germans.

By the end of October, according to the latest available statement of the Bank of German States, the note circulation in the hands of the public had increased from the DM 2.6 billion of June to about DM 5.9 billion. With new bank credits up about 3 billion since June, and additional funds released from blocked accounts, there must have been also some increase in free bank deposits. As a result the total purchasing power in the hands of the people may have doubled since the currency reform.

Meanwhile prices have again turned upward. The price of a pack of American cigarettes, which has been a sort of barometer of inflation, is up from a low point of three deutsche marks (nominally 90 cents) in the summer to about ten. With the price rise, people began to doubt the stability of the new currency. Money is circulating faster. To protect themselves, farmers and producers are once more withholding goods from the market. Talk of a new currency reform adds to a growing uneasiness, and transactions in deutsche mark in Switzerland at around 20 to the dollar have been reported. With prices and costs rising, German exporters complain that the present provisional exchange rate of 30 cents is too high.

The Lessons

What fresh readjustments in the currency may be undertaken still hangs in doubt. Nevertheless, the lessons of the experience are clear. First, reforms in a currency alone, however drastic and far-reaching, are not enough. Other measures must be adopted to put and keep an economy in balance. The achievement and maintenance of a sound money is a continuing task, from which attention must never be diverted.

The bitter cost of drastic and far-reaching currency reforms, however essential they may become, is that they place the stamp of legal authority on losses to creditors and savers. They take away any hope of even partial recovery of the purchasing power of past savings. Under such circumstances confidence in a reconstructed currency is a frail and delicate plant. It must be nurtured slowly to a vigorous growth in order that people may see that there is profit and protection instead of loss and insecurity when they put money in savings accounts, in life insurance and annuities, or out on loan. These are non-inflationary sources for financing capital reconstruction.

Under the circumstances, government must be satisfied with the direct benefits to it from currency reform, as in tax collections. The efforts of the community must be focussed on production from immediately available tools and resources. Major reconstruction tasks, however desirable they may be, must be deferred except as they can be financed from available tax revenues and from the savings of individuals and individual businesses. Impatience to get on with capital programs, and recourse to monetary inflation to make them possible, can set back the clock and blast again hopes for enduring recovery.

The problem in Germany is only an exaggerated case of a world-wide problem. All over the world governments, impressed by the desirability of building up industry and carrying through vast public works, are trying to go too fast, beyond available means, and resorting to inflationary financing to carry them through.

Condensed Statements of Condition

THE NATIONAL CITY BANK OF NEW YORK

***Head Office:* 55 Wall Street, New York**

Including Domestic and Foreign Branches

ASSETS

	Dec. 31, 1948	*Dec. 31, 1947*
Cash, Gold and Due from Banks	$1,532,119,431.07	$1,443,283,802.54
United States Government Obligations (*Direct or Fully Guaranteed*)	1,656,863,022.03	2,131,035,233.67
Obligations of Other Federal Agencies	20,800,544.06	28,214,818.55
State and Municipal Securities	223,270,860.19	231,062,937.10
Other Securities	80,736,634.65	80,775,281.37
Loans and Discounts	1,422,290,651.94	1,215,660,245.15
Real Estate Loans and Securities	2,693,232.40	2,819,262.64
Customers' Liability for Acceptances	22,194,546.28	22,309,380.78
Stock in Federal Reserve Bank	7,500,000.00	7,200,000.00
Ownership of International Banking Corporation	7,000,000.00	7,000,000.00
Bank Premises	27,686,864.86	28,491,252.22
Items in Transit with Branches	—0—	2,977,703.78
Other Assets	1,581,830.85	2,454,110.29
Total	$5,004,737,618.33	$5,203,284,028.09

LIABILITIES

	Dec. 31, 1948	*Dec. 31, 1947*
Deposits	$4,643,112,363.66	$4,874,418,234.40
Liability on Acceptances and Bills (*Own Acceptances in Portfolio Deducted 1948—$8,562,589.49; 1947—$8,427,813.35*)	26,031,806.46	25,033,128.12
Items in Transit with Branches	12,647,857.33	—0—
Reserves for:		
Unearned Discount and Other Unearned Income	5,925,327.28	5,673,264.16
Interest, Taxes, Other Accrued Expenses, etc.	21,006,274.30	23,393,787.62
Dividend	4,650,000.00	4,650,000.00
Capital	77,500,000.00	77,500,000.00
Surplus	172,500,000.00	162,500,000.00
Undivided Profits	41,363,989.30	30,115,613.79
Total	$5,004,737,618.33	$5,203,284,028.09

Figures of Foreign Branches are as of December 23.

For 1948, $272,043,209.00 ($251,123,478.00 in 1947) of United States Government Obligations and $643,355.26 ($3,330,105.00 in 1947) of other assets are deposited to secure $199,885,738.82 ($207,922,739.07 in 1947) of Public and Trust Deposits and for other purposes required or permitted by law.

Gold is included in Other Assets at December 31, 1947.

(MEMBER FEDERAL DEPOSIT INSURANCE CORPORATION)

CITY BANK FARMERS TRUST COMPANY

***Head Office:* 22 William Street, New York**

ASSETS

	Dec. 31, 1948	*Dec. 31, 1947*
Cash and Due from Banks	$ 24,260,705.47	$ 26,526,044.30
United States Government Obligations (*Direct or Fully Guaranteed*)	81,048,715.79	109,009,850.51
Obligations of Other Federal Agencies	1,048,351.88	1,077,404.61
State and Municipal Securities	5,591,935.26	5,412,048.50
Other Securities	101,037.50	101,037.50
Loans and Advances	794,038.43	1,209,888.42
Real Estate Loans and Securities	2,014,994.22	1,206,017.65
Stock in Federal Reserve Bank	600,000.00	600,000.00
Bank Premises	3,027,312.81	3,131,463.29
Other Real Estate	—0—	114,500.35
Other Assets	2,693,779.70	2,459,210.80
Total	$121,180,871.06	$150,847,465.93

LIABILITIES

	Dec. 31, 1948	*Dec. 31, 1947*
Deposits	$ 88,162,629.38	$118,155,374.01
Reserves (*Includes Reserve for Dividend 1948—$310,652.47; 1947—$310,621.20*)	3,587,040.80	4,076,164.56
Capital	10,000,000.00	10,000,000.00
Surplus	10,000,000.00	10,000,000.00
Undivided Profits	9,431,200.88	8,615,927.36
Total	$121,180,871.06	$150,847,465.93

For 1948, $3,654,387.56 ($7,847,838.59 in 1947) of United States Government Obligations are deposited to secure $1,135,778.77 ($2,092,739.02 in 1947) of Public Deposits and for other purposes required or permitted by law.

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